

1999 Country Reports on Economic Policy and Trade Practices

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JAPAN

Key Economic Indicators

(Billions of U.S. Dollars unless otherwise noted)

	1997	1998	1999	
<i>Income, Production and Employment:</i>				
Nominal GDP	4,192.7	3,783.0	4205.0	1/
Real GDP Growth (pct)	1.4	-2.8	0.5	1/
GDP by Sector:				
Agriculture	N/A	N/A	N/A	
Manufacturing	N/A	N/A	N/A	
Services	N/A	N/A	N/A	
Government	N/A	N/A	N/A	
Per Capita Income (US\$)	33,249	29,929	33,000	2/
Labor Force (millions)	67.9	68.0	67.8	3/
Unemployment Rate (pct)	3.4	4.1	4.7	4/
<i>Money and Prices (annual percentage growth):</i>				
Money Supply (M2+CD)	3.1	4.0	3.8	4/
Consumer Price Inflation	1.8	0.6	-0.1	3/
Exchange Rate (Yen/US\$)	121.0	130.9	117.03	5/
<i>Balance of Payments and Trade:</i>				
Total Exports FOB	409.2	374.4	394.1	6/
Exports to U.S. FOB	121.3	122.0	107.7	6/
Total Imports CIF	307.8	251.7	266.7	6/
Imports from U.S. CIF	65.7	57.9	47.1	6/
Trade Balance	101.5	122.7	127.4	6/
Trade Balance with U.S.	55.6	64.1	60.6	6/
Current Account Surplus/GDP (pct)	2.3	3.2	N/A	
External Public Debt	0	0	0	
Debt Service Payments/GDP (pct)	0	0	0	
Fiscal Deficit/GDP (pct)	-3.4	-6.0	N/A	
Gold and Foreign Exchange Reserves	220.8	215.9	272.8	7/
Aid from U.S.	0	0	0	
Aid from All Other Sources	0	0	0	

1/ January-June, seasonally adjusted, annualized; growth relative to Jan-June 1998.

2/ Embassy estimate.

3/ January-September, non-seasonally adjusted average.

4/ January-September, seasonally-adjusted average.

5/ January to September average.

6/ January-September, non-seasonally adjusted, annualized.

7/ As of end-September 1999.

Sources: Ministry of Finance; exports FOB, imports CIF customs basis; Economic Planning Agency; Bank of Japan, OECD Economic Outlook.

1. General Policy Framework

Japan's economy, the world's second largest at roughly 4.2 trillion dollars, is experiencing a significant recession. Most observers are predicting only meager growth this year, following a nearly 3 percent contraction in 1998.

Overall economic growth in Japan in the 1990s has been lackluster, despite occasional strong growth. (Until 1992-3, Japan had never experienced two consecutive years of less than 3 percent real growth in the postwar period.) A surge in asset prices to unsustainable levels and high rates of capital investment in the late 1980s gave way by 1991 to sharply slower growth, the need for corporate restructuring and balance sheet adjustment by businesses. A substantially weakened Asian demand for Japanese exports and domestic banking system concerns, also continue to weigh heavily on the economy.

In recent years, the Japanese Government has used public spending to offset weak or negative private demand growth. Several fiscal stimulus packages beginning in August 1992 have boosted public investment spending substantially, while temporary tax cuts have supported public demand.

Japan posted a global trade surplus of \$123 billion in 1998, with a \$51.5 billion bilateral surplus with the United States. Both of these numbers are expected to rise significantly in 1999. Through the first nine months of 1999, import volume was also higher compared with the same period in 1998.

In order to ease credit conditions to support the economy, the Bank of Japan lowered the official discount rate nine times between mid-1991 and September 1995, from 6.0 percent per year to 0.5 percent where it has remained. The Bank of Japan also instituted some temporary programs to make credit more available to corporations. Recently the overnight call rate has been left at zero.

2. Exchange Rate Policy

The yen has been volatile against the dollar in 1998-99. The average exchange rate through the first nine months of 1999 was 117 yen per dollar, versus 130 yen per dollar in 1998. A new Foreign Exchange Law in April 1998 significantly decontrolled most remaining barriers to cross-border capital transactions.

3. Structural Policies

Pricing Policy: Japan has a market economy, with prices generally set in accordance with supply and demand. However, with very high gross retail margins (needed to cover high fixed and personnel costs) and a complex distribution system, Japan's retail prices exhibit a greater

downward stickiness than in other large market economies. Moreover, some sectors such as construction are susceptible to cartel-like pricing arrangements, and in many key sectors heavily regulated by the government (i.e., transport and warehousing), it can still exert some limited temporary authority over pricing.

Tax Policy: Total tax revenues as a share of GDP in Japan are comparable to the United States and the UK, and on the low end of OECD countries. Japan had a relatively high corporate tax rate, but recent legislation has reduced the (combined central and local government) effective corporate tax rate from 47 percent to 40.9 percent, bringing it in line with other OECD countries. The maximum marginal rate for personal income taxes was also reduced from 65 percent to 50 percent. There is a general consumption tax (actually a broad value-added tax) of 5 percent, although small retail outlets are exempted.

Regulatory and Deregulation Policy: Japan's economy is highly regulated. Although the government and business community recognize that deregulation is needed to spur growth, opposition to change remains strong among vested-interest groups, and the economy remains burdened by numerous national and local government regulations, which have the effect of impeding market access by foreign firms. Official regulations also reinforce traditional Japanese business practices that restrict competition, help block new entrants (domestic or foreign) and raise costs. Examples of regulations that act as impediments include: exceedingly high telecommunications interconnection rates, prolonged approval processes for medical devices and pharmaceuticals, and severe restrictions on foreign lawyers.

In June 1997, the President and the Japanese Prime Minister agreed on an Enhanced Initiative on Deregulation and Competition Policy under the U.S.-Japan Framework Agreement. During its third year, the Initiative is focusing on achieving concrete deregulation in key sectoral and structural areas in Japan, such as telecommunications, housing, energy, financial services, medical devices and pharmaceuticals, distribution, competition policy, and transparency in government rule-making.

4. Debt Management Policies

Japan is the world's largest net creditor. The Bank of Japan's foreign exchange reserves exceed \$250 billion. It is an active participant together with the United States in international discussions of developing-country indebtedness issues in a variety of fora.

5. Significant Barriers to U.S. Exports

Japan is the United States' third largest export market, after Canada and Mexico. The United States is the largest market for Japanese exports. However, in many sectors U.S. exporters continue to enjoy incomplete access to the Japanese market. While Japan has reduced its formal tariff rates on most imports to relatively low levels, it has maintained non-tariff barriers, such as non-transparency, discriminatory standards, and exclusionary business

practices, and tolerates a business environment that protects established companies and restricts the free flow of competitive foreign goods into the Japanese market.

Transportation: In January 1998, the U.S. and Japan concluded a new agreement to significantly liberalize the trans-Pacific civil aviation market. This eliminated restrictions and resolved a dispute over the rights of longtime carriers to fly through Japan to other international destinations. It opened doors for carriers that recently entered the U.S.-Japan market, nearly tripling their access to Japan. The agreement also allowed code sharing (strategic alliances) between carriers for the first time, thereby greatly increasing their operational flexibility. While U.S. carriers have been generally happy with the results of the 1998 agreement, there is growing concern over the adequacy of facilities and a scarcity of slots at Japanese airports.

American ocean going ships serving Japanese ports have long encountered a restrictive, inefficient and discriminatory system of port transportation services. After the Federal Maritime Commission (FMC) ruled in early 1997 that Japan maintained unfair shipping practices and proposed fines against Japanese ocean freight operators, the Japanese Government pledged to grant foreign carriers port transport licenses, and, at the same time, to reform the prior consultation system which allocates work on the waterfront and requires carriers to obtain approval for any change in their operations. The FMC imposed fines in September 1997 after Japan failed to carry out the reforms. Shortly afterwards, however, the government committed itself to actions that would have provided a solid foundation for reform of Japanese port practices. However, a final report on deregulation issued by the Japanese government in mid-1999 was discouraging for its lack of aggressive proposals for deregulating ports.

Agricultural and Wood Products: Some progress has been achieved through continued U.S. pressure on Japan to liberalize its markets for imported agricultural and wood products. However, tariffs on most processed food products remain relatively high, and other barriers to a liberalized market remain. For example, Japan continues to restrict, for phytosanitary reasons, the entry of numerous fruits and vegetables, such as pears and potatoes. In accordance with its WTO obligations, Japan opened its rice market to imports under a Tariff Rate Quota. However, the U.S. continues to press Japan to introduce this rice to consumers, rather than earmarking it for stockpiles or food aid to third countries. Tariffs for wood products are being reduced under Japan's Uruguay Round commitments, but they continue to pose barriers to market access. Moreover, a number of unresolved market access issues are being discussed in the U.S.-Japan deregulation dialogue, such as recognition of foreign testing organizations, approval of Japan Industrial Standards (JIS) grademark equivalency for U.S. manufacturers of nails, and food waste disposals.

Telecommunications and Broadcasting: Japan is a signatory of the WTO Basic Telecommunications Agreement of 1997, which promotes market access, investment and pro-competitive regulation in the telecommunications industry. In recent years, Japan has adopted a series of significant measures to foster a more pro-competitive regime in the telecommunications sector. However, access to telecommunications and broadcasting market in Japan remains

constrained by both regulatory and anti-competitive practices. New entrants face much higher costs and longer waiting periods for connecting to the local dominant carrier's network than in other advanced countries, deterring competition. In addition, new carriers' difficulty in gaining access to facilities and land to build their networks, government restrictions on combining owned and leased facilities in creating a network, and the lack of access to discrete portions of the local dominant carriers' network at reasonable costs have slowed and raised the costs of new carriers' entrance. Finally, discriminatory and anti-competitive discount pricing plans by the dominant carriers have put new entrants at a serious disadvantage in developing Internet services. The U.S. Government has been applying pressure on Japanese regulators to take steps to address these issues under the U.S.-Japan Enhanced Initiative.

Foreign telecommunications equipment suppliers continue to have difficulty selling to the Japanese public sector, having an extremely low share of this market. In addition, problems remain in selling to NTT (Nippon Telegraph and Telephone) companies, which collectively are the largest purchaser of telecommunications equipment in Japan. Foreign investment restrictions remain on NTT and on Direct-To-Home (DTH) satellite broadcasting companies.

Standards, Testing, Labeling and Certification: Standards, testing, labeling and certification problems hamper market access in Japan. In some cases, advances in technology, products or processing make Japanese standards outdated and restrictive. Domestic industry often supports standards that are unique and restrict competition, although in some areas external pressure has brought about the simplification or harmonization of standards to comply with international practices. Fresh agricultural products continue to be subject to extensive restrictions, including phytosanitary restraints, required overseas production-site inspections, fumigation requirements for non-quarantine pests, and tariff rate or minimum access restrictions.

Japan requires repeated testing of established quarantine treatments each time a new variety of an already approved agricultural commodity is approved for importation into Japan. For example, Japan has approved red and golden delicious apples for importation, but required that the quarantine treatment be retested for other almost identical varieties. The U.S. challenged this redundant testing requirement in the WTO, arguing that it has no scientific basis and serves as a significant trade barrier. Completion of the testing for each variety takes at least two years and is costly to the U.S. Government and U.S. producers. In October 1998, a WTO dispute settlement panel found that Japan's varietal testing requirement for agricultural products violated its WTO obligations. Japan has agreed to implement the terms of the WTO decision by the end of 1999.

Foreign Direct Investment (FDI): FDI in Japan has remained extremely small in scale relative to the size of the economy. In Japan fiscal year 1998, Japan's annual inward FDI totaled 10.5 billion (up from \$6 billion the previous year) but still only 0.27 percent of its GDP. (Comparatively, preliminary estimates for the United States FDI in 1998 was \$188 billion). Although in Japan, inward foreign investment is on the rise, Japan continues to host the smallest

amount of FDI as a proportion of total output of any major OECD nation. The low level of FDI reflects the high cost-structure of doing business (for example, registration, licenses, land prices and rents), the legacy of former investment restrictions, and a continuing environment of structural impediments to greater foreign investment. The challenges facing foreign investors seeking to establish or enhance a presence in Japan include: laws and regulations that directly or indirectly restrict the establishment of business facilities, close ties between government and industry, informal exclusive buyer-supplier networks and alliances, high taxation, and a difficult regulatory environment for foreign or domestic acquisitions of existing Japanese firms.

Recently, the Japanese Government has implemented potentially useful measures for increasing FDI, including easing restrictions on foreign capital entry. Additional steps include the implementation by Japanese enterprises of consolidated accounting by March 31, 2000. This step will greatly enhance financial transparency and facilitate mergers and acquisition and other investments. The government in October 1999 introduced legislation modeled on the US Chapter 11 bankruptcy procedures. The legislation should facilitate corporate restructuring and buy-outs by foreign and domestic investors.

In October 1998, the U.S. Government proposed to the Japanese Government 18 new reforms in the areas of mergers and acquisitions, land, and labor policy to improve Japan's environment for foreign direct investment. In May 1999, both governments submitted a Joint report to the President and Prime Minister on the status of Japan's investment climate and measures under consideration. The bilateral Investment Working Group held talks in Tokyo in October 1999 that covered a range of investment issues. The group intends to continue consultations and the exchange of information as stipulated in the Joint report.

Government Procurement Practices: Japan is a party to the 1996 WTO Government Procurement Agreement. While government procurement in Japan at the national, regional and local levels generally conform to the letter of the WTO agreement, there are reports that at some procuring entities, established domestic competitors continue to enjoy preferential access to tender information. In some sectors, unfair low pricing remains a problem, preventing companies from winning contracts based on open and transparent bidding procedures. Moreover, some entities continue to draw up tender specifications in a way that favors a preferred vendor, using design-based specifications rather than more neutral performance-based specifications.

Customs Procedures: The Japanese Customs Authority has made progress in automating its clearing procedures, and efforts are underway to integrate the procedures of other government agencies over the next several years. However, U.S. exporters still face relatively slow and burdensome processing.

6. Export Subsidies Policies

Japan's official development assistance for Asian countries in 1998 rose 71 percent from the previous year as the government focused on helping its neighbors recover from the region-

wide economic crisis. Japan remained the world's top aid donor in 1998 for the eighth consecutive year, disbursing a total of \$10.77 billion, up 14.2 percent from 1997. Although Japan had been moving towards untying its aid, during the past 2 years this trend has reversed. Both its Environmental Aid loans and its Special Yen loans are tied to the purchase of Japanese products. Not only does this limit U.S. firm's ability to participate in these projects; it also denies recipient countries the opportunity to use this aid as efficiently as possible. This trend towards retying has been actively opposed by the U.S. Government. In addition, the USG continues to address U.S. industry concerns that feasibility studies funded by Japanese grant aid, and tied to the use of Japanese firms, results in technical specification that unduly favor Japanese firms.

7. Protection of U.S. Intellectual Property Rights

Japan is a party to the Berne and Universal Copyright Conventions, the Paris Convention on Industrial Property, the Patent Cooperation Treaty, and the WTO Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPs). Japan is on the Special 301 Watch List because of continuing U.S. concerns about the operation of Japan's patent system and the protection of trade secrets and computer software.

While Japan's IPR regime affords national treatment to U.S. entities, the U.S. has long been concerned by the long processing time for patent examination. Although Japan has reduced patent pendency from 36 to 28 months, this is still longer than in other industrialized countries. Lengthy patent pendency, coupled with a practice of opening all patent applications to public inspection 18 months after filing, exposes applications to lengthy public scrutiny with the potential of limiting legal protection.

Many Japanese companies use the patent filing system as a tool of corporate strategy, making many applications to cover slight variations in technology. However, a February 1998 decision by Japan's Supreme Court to permit an infringement finding under the "the doctrine of equivalence" may reduce this practice and is a positive step toward broadening Japanese courts' generally narrow interpretation of patent rights. The rights of U.S. subscribers in Japan can be circumscribed by filings of applications for similar inventions or processes. Some small revisions to Japan's patent and trademark law aimed at improving protection right holders will take effect early in 2000.

Japan's protection of trade secrets is inadequate. Because Japan's Constitution prohibits closed trials, the owner of a trade secret seeking redress for misappropriation of the secret is put in the difficult position of not being able to protect a trade secret without disclosing it publicly. While a recent amendment to Japan's Civil Procedures Act excludes Japanese court records containing trade secrets from public access, this legislation does not adequately address the problem. Court proceedings of trade secrets remain open to the public and neither the parties nor their attorneys have confidentiality obligations.

Japan's Trademark Law was revised in 1997 to speed the granting of trademark rights, strengthen protection to well-known trademarks, address problems related to unused trademarks, simplify registration procedures, and increase infringement penalties. The effect of the revisions, however, is not yet clear. Historically, trademark registration in Japan has been slow, requiring approximately 36 months. Since trademarks must be registered in Japan to ensure enforcement, delays make it difficult for foreign parties to enforce their marks. In addition, concerns have been raised by U.S. firms regarding Japan's re-exportation of suspected counterfeit merchandise to be re-exported which is inconsistent with article 59 of the Trade-Related Aspects of Intellectual Property Rights (TRIPs) agreement.

End-user software piracy remains a major concern of U.S. and some Japanese software developers. An amendment to Japan's Civil Procedures Law to award punitive damages rather than actual damages would help increase the deterrent against software piracy.

8. *Worker Rights*

a. The Right of Association: Japan's Constitution and domestic labor law provide for the right of workers to freely associate in unions. Approximately 23 percent of Japan's labor force is unionized. The Japanese Trade Union Confederation (RENGO), which represents 7.8 million workers, is the largest labor organization. Both public and private sector workers may join a union, although members of the armed forces, police and firefighters may neither form unions nor strike. The right to strike, although implicit in the constitution, is seldom exercised. The law prohibits retribution against strikers and is effectively enforced.

b. The Right to Organize and Bargain Collectively: The constitution provides unions with the right to organize, bargain and act collectively. These rights are freely exercised, and collective bargaining is practiced widely, particularly during the annual "Spring Wage Offensive" of nationwide negotiations.

c. Prohibition of Forced or Compulsory Labor: Article 18 of the Japanese Constitution states that "No person shall be held in bondage of any kind. Involuntary servitude, except as punishment for crime, is prohibited." This provision applies both to adults and children, and there are no known cases of forced or bonded labor.

d. Minimum Age for Employment of Children: By law, children under the age of 15 may not be employed and those under age 18 may not work in dangerous or harmful jobs. Child labor is virtually non-existent in Japan, as societal values and the rigorous enforcement of the Labor Standards Law protect children from exploitation in the workplace.

e. Acceptable Conditions of Work: Minimum wages are set on both a sectoral and regional (prefectural) level. Minimum wages ranged from \$50 per day in Tokyo to \$42 in Okinawa. The Labor Standards Law provides for a 40-hour work week in most industries and mandates premium pay for hours worked beyond 40 hours in a week or eight hours in a day. However, labor unions criticize the Japanese Government for failing to enforce working hour regulations in

smaller firms. The government effectively administers laws and regulations affecting workplace safety and health.

f. Worker Rights in Sectors with U.S. Investment: Labor regulations, working conditions and worker rights in sectors where U.S. capital is invested do not vary from those in other sectors of the economy.

**Extent of U.S. Investment in Selected Industries -- U.S. Direct Investment Position Abroad
on an Historical Cost Basis -- 1998**

(Millions of U.S. Dollars)

Category	Amount
Petroleum	4,496
Total Manufacturing	14,224
Food & Kindred Products	528
Chemicals & Allied Products	2,608
Primary & Fabricated Metals	365
Industrial Machinery and Equipment	3,588
Electric & Electronic Equipment	2,043
Transportation Equipment	1,724
Other Manufacturing	3,368
Wholesale Trade	4,948
Banking	539
Finance/Insurance/Real Estate	12,318
Services	1,415
Other Industries	212
TOTAL ALL INDUSTRIES	38,153

Source: U.S. Department of Commerce, Bureau of Economic Analysis.